ESG Materiality Newsletter

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Federated Hermes Limited

www.hermes-investment.com
For professional investors only

Introduction

Welcome to our **Global Emerging Markets (GEMs) ESG Materiality** commentary – a bi-annual publication that demonstrates our engagement activity with portfolio companies and showcases holdings helping to create positive impacts in line with the UN's Sustainable Development Goals (SDGs).[1]

In the latest issue, we share our voting and engagement activity over the last 12 months, providing an update on the 'Corporate Value-Up' initiative in South Korea and discuss our engagement with Samsung Electronics.

We also shine the spotlight on the GEMS **climate risk framework**, sharing our climate assessments for **Max Healthcare** and the Brazilian freight railway operator **Rumo**, and provide an update on our latest impact data and engagements (e.g. **Banco de Chile**, **BYD** and **ICICI Bank**).

Our vision for responsible long-term investing in emerging market equities

At a glance

- We aim to select quality companies, benefitting from structural growth drivers and trading at attractive valuations, run by management teams that are willing to confront sustainability challenges.
- We avoid sectors we consider to be unsustainable in the long term and will not invest in companies facing material ESG risks without a credible mitigation strategy.
- We seek to improve sustainability performance through engagement as a means of future proofing the business from medium- to long-term risks, taking into account the specific characteristics of emerging markets as well as contributions to the SDGs.
- We maintain a low-carbon footprint[2] and prioritise climate engagements with holdings with higher emissions and/or climate-related risks.

Portfolio snapshot[3]

Over the last 12 months we engaged with companies representing 88% of AUM, made progress with 39% of objectives.

The companies we invested in delivered:[4]

Greenhouse gas (GHG) emissions (Scope 1/2/3):[5]
66% lower than the benchmark

163 million tonnes of CO_2 avoided

545 million litres of water saved

Circular economy:
189 thousand tonnes of conventional material production avoided

Health care treatments for
6.9 million people

Financial services for
236 million previously excluded people

An average of
24% female board representation and
37% female workforce participation

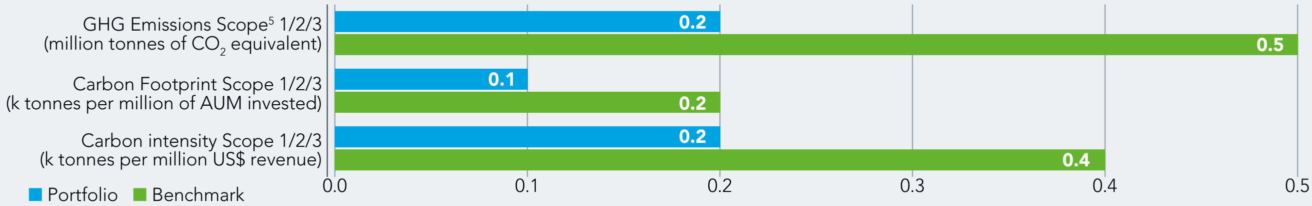
Average employee turnover of **17%**

[1] Sustainable Development Goals (SDGs): The SDGs are a set of 17 interconnected goals that were adopted by all UN member states in 2015. They are a universal call to action to end poverty, protect the planet and improve the lives and prospects of everyone, everywhere, by 2030.
[2] In relation to the MSCI Emerging Markets index benchmark
[3] As at 30 November 2024.
[4] Federated Hermes as at 30th November 2024. Portfolio snapshot impact data has been calculated in partnership with our impact measurement partner, Net Purpose.
[5] Includes Scope 3 upstream only.

Figure 1:

Our portfolio's carbon footprint, Q2 2024

Federated Hermes GEMs Equity Strategy vs. MSCI EM benchmark



Source: Federated Hermes as at 30 November 2024. The benchmark is MSCI Emerging Markets index.

We maintained a low carbon footprint versus the benchmark (see above) and prioritised engagement with companies with higher emissions and those that are identified as exposed to higher physical and transition risks in our climate risk framework.

Our engagement impact

The last 12 months in numbers (GEMs Equity core Strategy)

We had

168 engagements with **58** companies

We engaged

88% of AUM

We made progress on

43 objectives **(39%)**

We pursued

90 objectives for change as follows:

46 environmental

23 social

21 governance (including strategy, risk and communication)

Our most engaged SDGs:

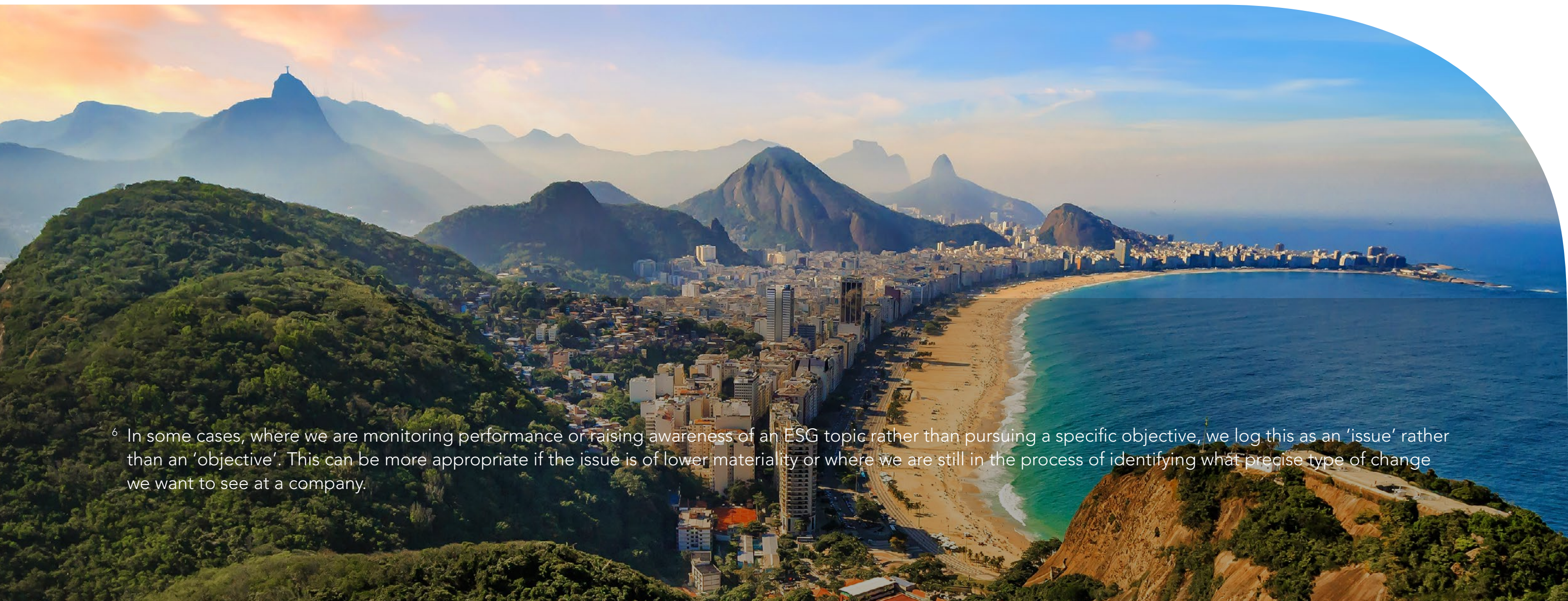
27 objectives/issues[6]

35 objectives/issues

36 objectives/issues

48 objectives/issues

59 objectives/issues



[6] In some cases, where we are monitoring performance or raising awareness of an ESG topic rather than pursuing a specific objective, we log this as an 'issue' rather than an 'objective'. This can be more appropriate if the issue is of lower materiality or where we are still in the process of identifying what precise type of change we want to see at a company.

	Engagement objective or issue	Theme	Progress update (momentum[8]/status)
ASMPT	Measure Scope 3 emissions and pursue SBTi validation	GHG emissions reduction SDGs 12, 13	**Start date: Q3 2024** The company has recently set Scope 1 and 2 interim emissions reduction targets; however it has not yet measured and disclosed Scope 3 emissions or set a Scope 3 reduction target. We initiated engagement on this issue, encouraging the company to address these gaps as well as to seek Science Based Targets Initiative (SBTi) validation. The company highlighted that it is working with suppliers to calculate Scope 3 emissions and is working on a roadmap to engage with the SBTi. While no timeline has been indicated, we welcome the company's intention and will continue to engage.
Grupo Financiero Banorte	Implementation of Taskforce on Nature-related Financial Disclosures (TNFD) recommendations		**Start date: Q2 2023** The company has confirmed it remains committed to adopting the TNFD recommendations and has promised to publish its first report in 2026. Banorte's initial reporting will be limited to the tourism and agriculture segment of its loan book – its most material sectors in terms of biodiversity impact. We outlined our expectations that this coverage should be expanded over time to include additional high impact sectors. The company has been developing its in-house expertise to help achieve this. It recently hired two biologists to focus on biodiversity impact assessment. Banorte already has some nature-based exclusions in place, focused on the illegal wildlife trade and logging in tropical rainforests. We encouraged the company to review the list and potentially expand it as it seeks to develop its strategy.
Itausa	Disclose ESG performance metrics across holdings portfolio	Long-term sustainability strategy	**Start date: Q2 2024** Itausa has recently implemented an active ESG investor strategy, including engagement and performance monitoring with key holdings. It has established considered and detailed ESG metrics in partnership with investees, and plans to develop targets related to these metrics and monitor performance over time. The company does not intend to report details of this engagement strategy until it has progressed further. However, we have encouraged it to begin publishing engagement progress in the next 12-24 months, including engagement objectives and performance against key metrics. The company was very receptive to this feedback.
Banco de Chile	Measure and disclose financed emissions	GHG emissions reduction SDGs 12, 13	**Start date: Q1 2023** We asked the bank to measure and disclose its financed emissions, highlighting that it is behind many global and regional peers which are doing so and setting targets for their reduction in line with the goals of the Paris Agreement. Banco de Chile confirmed during a recent meeting that financed emissions measurement is underway, and that – more broadly – the company is developing a climate strategy and has been initiating climate risk assessments. It hopes to publish more TCFD-aligned disclosures in 2025, noting that local regulations will require a number of environmental disclosures by 2026. We strongly encouraged the company to disclose at least partial financed emissions next year. While progress has been slow, we welcome Banco de Chile's increased focus on climate risk and strategy and will continue to engage.
Richter Gedeon	Set science-based emission reduction targets	GHG emissions reduction SDGs 12, 13	**Start date: Q4 2022** During our latest meeting, the company noted that its existing business strategy covers the period 2018-28, and it is developing a new strategy for 2025-35. Aligned with this, Richter Gedeon is currently working on a project to develop greenhouse gas emissions reduction targets that are validated by the Science Based Targets initiative (SBTi), which it hopes to publish by the end of next year. We welcome the company's increased ambition in this area.
ICICI Bank	Social and financial inclusion strategy	Access and affordability SDGs 1, 5, 8	**Start date: Q3 2023** In our engagements with ICICI Bank, we have encouraged it to formalise a long-term strategy for social and financial inclusion. The bank supports rural development through its products and corporate social responsibility activities, however, its disclosures focus on current activities and its strategic direction is unclear. We have encouraged the bank to adopt a forward-looking outlook and establish targets to reach under-served populations. To achieve this, it will need to develop new targeted products; support efforts to increase financial literacy in poorer areas; put safeguards in place for more vulnerable people; and outline how it will measure outcomes. The company has welcomed our input and acknowledged these expectations. We have seen an increase in disclosures and related activities and its rural portfolio has seen material growth.
BYD	Sustainability strategy development including social impact	Multiple objectives SDGs 5, 7, 8, 12	**Start date: Q2 2023** During our engagements with BYD this year – including conversations with BYD's overseas CFO, Board Secretary, and Head of Investor Relations – we have seen a positive material positive shift in its attitude towards sustainability. While BYD manufactures electric vehicles (EVs), which are an inherently sustainable product, it needs to ensure that its production processes are as sustainable as possible. We have encouraged the company to develop a sustainability strategy that covers its operations and value chain and addresses both social and environmental impacts. The company has clearly acknowledged this expectation and has asked for our input on how to implement best practices, and establish the appropriate standards, to work towards it.

[8] Green = Strong momentum with objective met or we expect to met in the near future. Yellow = Good progress but engagement continuing or recently initiated. Red = engagement stalling.

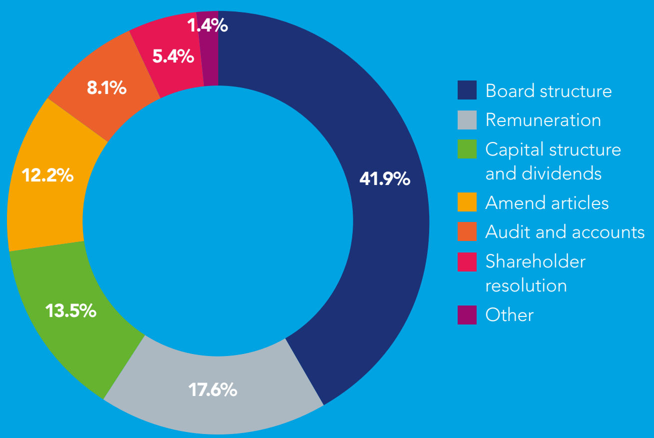
	Engagement objective or issue	Theme	Progress update (momentum[8]/status)
KEC International	Board independence and gender diversity	Board effectiveness SDGs 5	**Start date: Q2 2023** When we began engaging with KEC International, board independence was at only 36%, and board gender diversity was 9%, partly because of the long tenures of some directors. We raised our concerns with the company and shared our expectations that board independence should be at least 50% and board gender diversity should be 20%. We encouraged the company to refresh its board; and broaden its search for new directors and identify female candidates. In 2024, KEC International added four new independent directors to the board (to reach 70% board independence). These additions included a second female independent director – bringing gender diversity to 20% to meet our minimum expectations.
JD.com	Adding director election agenda to the AGM; engagement with the board of directors	Board effectiveness and investor protection and rights SDGs N/A	**Start date: Q2 2021 and Q2 2023** Since 2021, we have been urging JD.com to include a director election agenda to its annual general meeting (AGM). It has been challenging. We have requested access to the company's AGM next year, and have been welcomed. Since 2023, we have also been pursuing engagement with the board of directors, however, the company has expressed concerns about investors speaking to independent directors. We explained that board level access, especially to independent directors, is essential, particularly in the absence of director elections and the presence of a dual-class structure. We highlighted examples of our working with other companies, where we spoke to board directors, which helped establish investor confidence. The company agreed to escalate our request (once again).
Localiza Rent a Car	Net zero commitment and target-setting	GHG emissions reduction SDGS 7, 13	**Start date: Q4 2022** Localiza's flex-fuel vehicle fleet is uniquely positioned to take advantage of lower emission biofuels, and make a significant contribution to the short-to-medium-term decarbonisation of road transport in the passenger vehicle/light-duty segment. We have encouraged the company to develop a formal decarbonisation strategy that will further align its fleet with the long-term decarbonisation of the sector. For example, strategies to encourage the use of ethanol over gasoline by renters; and opportunities to expand the penetration of lower-carbon vehicles in its fleet, such as hybrids and EVs. The company is very open to engagement and already has a strategic focus on fuel efficiency.

Governance & Voting

The GEMs Equity team has continued with efforts to improve board diversity and independence across various markets through engagement and voting at company meetings, while also focusing on capital allocation and remuneration. The effective use of capital by senior management is key to long-term shareholder value and remained a focus of our engagements in 2024.

In the GEMs Equity Strategy, we voted against management on at least one issue at 29.2% of all meetings in 2024, with the majority of these votes against related to board structure (41.9%) including at **Max Healthcare**, **ASMPT**, **KEC International** and **Gedeon Richter** all of which fell short of our expectations on board independence and/or diversity (see Figure 2).

Figure 2: Breakdown of votes against management in last 12 months (per issue)



Source: Federated Hermes December 2024.

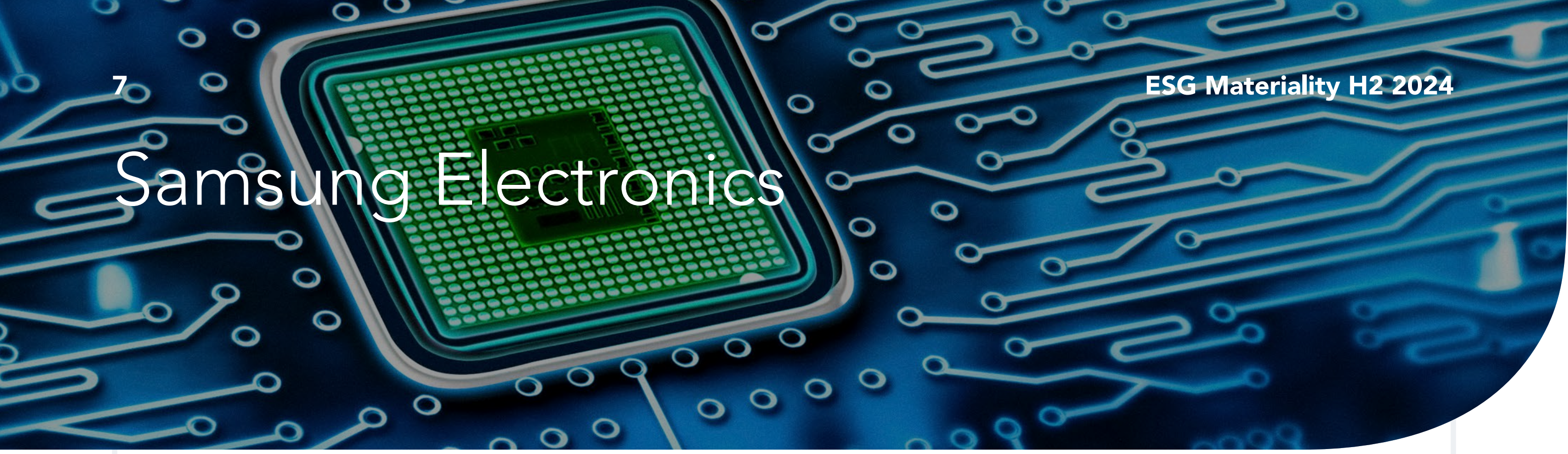
We always take into consideration qualitative and contextual factors in our voting decisions including whether the company is showing progress on governance factors. For example, at **Kanzhun**, we voted for the three directors on the ballot despite them not meeting our independence expectations. We noted the recent progress on this front given board independence has increased to 33% with a 100% independent audit committee, and we recognised the need for stability following the initial public offering (IPO). We are engaging with the company on succession planning and the need to bring more international experience to the board going forward.

Likewise, at **Voltronics**, we voted for the combined CEO/chair on the grounds that the company is already above average in a Taiwanese context – 50% independent, 38% female representation with fully independent committees – and the combined CEO/chair has delivered excellent value for shareholders. Separation of the roles is a long-term consideration, but we felt this was the wrong time to change the current set up, and the high level of independence on the board and committees provides appropriate checks and balances to the CEO/chair.

In **South Korea**, we continued to watch the progress of the 'Corporate Value-Up Programme' in the hope that it may help reverse so-called 'Korea discount'. Companies moved to make their 'Value Up' disclosures during Q3 to qualify for the Financial Services Commission's 'Value Up' Index – the latter being based on a mix of criteria including shareholder returns and capital efficiency. While the initiative seems to have galvanised some positive action, it is too early to tell whether it will have the desired impact given that arguably it does not tackle the underlying issues (e.g. complex cross holding and ownerships structures, lack of tag-along rights, narrow definitions of fiduciary responsibility of directors). Following President Yoon Suk Yeol's imposition and retraction of martial law, the political situation in South Korea has become quite uncertain. We are watching the developments closely to determine how it might impact on our investments and the progress of the 'Corporate Value-Up Programme'.

In particular, we have stepped up our engagement with **Samsung Electronics** in light of the poor performance of its High Bandwidth Memory (HBM) and foundry divisions especially, raising questions about execution and capital allocation, employee incentivisation schemes, and board composition amongst other topics (see below).

This information does not constitute a solicitation or offer to any person to buy or sell any related securities or financial instruments.



Samsung Electronics

As long-term shareholders of Samsung, we wrote to the board to express our deep concern and disappointment regarding the recent performance of the company, especially when compared to its key peers in the semiconductor industry. Companies like TSMC and SK Hynix have demonstrated strong growth and profitability by focusing on their core competencies, technology leadership, and execution.

We believe that Samsung can also achieve similar success by implementing a more focused and strategic approach and the current trajectory is not aligned with its potential. With this in mind, we requested further clarity and dialogue on key topics including:

1. Execution and capital allocation:

- **We flagged that it is difficult for minority investors to ascertain the underlying reasons for the sub-optimal results from the foundry and HBM divisions given the lack of disclosures.**
- We requested an update on the management's perspective, the lessons learnt and the strategic alternatives under consideration. We also highlighted that investors would benefit from understanding how competing demands for capital at the memory and foundry businesses are evaluated and how final decisions on capital expenditure are made.

2. Risk management:

- The importance of robust risk management processes to mitigate potential downside risks and protect shareholder value.

3. Corporate communications and transparency:

- The need for enhanced communication with shareholders and stakeholders to foster trust and transparency and the importance of timely and accurate disclosure of material information to maintain market confidence.

4. Employee incentivisation:

- **Performance-based compensation:** The importance of aligning employee compensation with company performance to motivate employees and drive results.
- **Share-based compensation:** The value of share-based compensation schemes, which are widely used in the technology sector to align the interests of employees with shareholders. These schemes can include stock options, restricted stock units, and performance-based share awards.

5. Shareholder return policy:

- **Dividend policy:** The opportunity to review the company's dividend policy to ensure that it provides a fair and sustainable return to shareholders.
- **Share buybacks:** The role of share buybacks as an alternative means of returning capital to shareholders, particularly during periods of undervaluation.

We requested a meeting with the chair to discuss the above, as well as board composition, with a view to supporting and working with management to create long-term value for all shareholders.

The role of share buybacks as an alternative means of returning capital to shareholders, particularly during periods of undervaluation.

The importance of aligning employee compensation with company performance to motivate employees and drive results.

GEMs climate change risk framework

Hayley McGuinness, Associate Director – Responsible Investing & Sustainability

The GEMs team have developed a climate change risk framework with the goal of mitigating risks in the portfolio and identifying climate related opportunities. Please find a summary of the framework and how it is applied in Figure 3.

Figure 3: Climate Change Risk Framework

Vulnerability Identifying exposure based on nature of business and location of operations and revenue generation	Contextual adjustment Understanding likelihood, severity and timing of impact, considering mitigating factors	Financial impact Modelling financial impact or risk premium and engaging on appropriate actions
• Initial risk screen (Internal proprietary tool) – focuses on carbon intensity of operations and value chain, and exposure to regulatory risk; and geographic revenue mapping to country climate scores • Planetrics assessment – provides an initial screen of policy and legal, technology and market risk based on scenario modelling; with heavy weighting given to carbon cost risk • Water intensity assessment – assessment of company's core activities against CDP Water impact index	Assessment of company transition risks, and realistic company transition pathway(s), considering: • Sector risks and opportunities of an economic transition to net zero 2050, applying a geographic lens e.g. substitution risk, stakeholder urgency. • Sector adaptation and mitigation pathways, applying a geographic lens e.g. practicality of implementation. • Maturity of current climate strategy relative to peers. • Emissions profile (Scope 1, 2 & 3). Asset-level physical climate risk profile, including a: • Quantitative assessment of risk exposure of key assets to key physical climate risks • Qualitative assessment of residual risk level to operations and value chain: based on critical evaluation of likely real-world impact and existing adaptions in place	**Qualitative identification of potential financial impacts** across the following categories: • Capex requirements • Inflationary costs • Revenue loss • Stranded assets • Regulatory costs • Insurance or damage costs Modelling of valuation impact: integration of potential financial impacts into the valuation model Engagement on climate risk findings: with the intent to strengthen company risk management and/or gather further insight to feed into maturity assessment and/or valuation modelling

Transition risk

Bottom-up approach	Federated Hermes is aligned with the goals of the Paris Agreement – a commitment to net zero portfolio emissions by 2050, which is supported by interim targets outlined in our Climate Action Plan.[9] The GEMs transition risk framework recognises that such a commitment requires a deep understanding of transition risk and management strategies across the Strategy. As a starting point, it identifies how transition risk is spread across our Strategy and in which holdings it is concentrated (See Risk Matrix included in GEMs ESG Materiality H2 2023 report).[10] A bottom-up approach is then applied for higher-risk holdings to assess current alignment to net zero at the holding level, and the potential financial impact of both the economic transition to net zero by 2050, as well as the company's own decarbonisation pathway.
Assesses the most realistic short-medium term pathway for net zero 2050 alignment, anchored in EM context	Our analysis aims to paint a realistic portrait, anchored in the company's sector and geographic context, of: 1. What transition risks are likely to have a material financial impact on the company in the short, medium and long term; 2. The most likely decarbonisation pathway the company may pursue in the short, medium and long term, taking into account the emerging market context where transition risks differ from developed markets due to regulation, technology, resources, cost and social goals. Note: the premise of this exploration is an assumption that each individual holding will pursue net zero by 2050.
Climate-adjusted valuation	The focus of our climate-adjusted valuation is then to account for the financial impact of the transition risks identified, and of executing the realistic decarbonisation pathway identified for the business. In practise, it largely translates to a return on investment (ROI) case for that pathway.

[9] https://www.hermes-investment.com/uk/en/intermediary/climate-change-hub
[10] https://www.hermes-investment.com/uk/en/institutions/insights/active-esg/gems-esg-materiality-h2-2023/

Physical risk

Similar to the transition risk framework, GEMs physical risk framework firstly identifies how physical risk is spread across our fund and in which holdings the risk is concentrated. A bottom-up approach is then applied to higher-risk holdings to translate physical climate risk exposure into financial impact, through four key steps:

Asset level assessment of residual risk

Climate-adjusted valuation

1. Identification of key assets: Focus on revenue-generating assets e.g. production assets, infrastructure.
2. Screening of asset-by-asset exposures: We have developed an asset-based physical climate risk tool that allows us to systematically assess the physical risks[11] faced and their likely severity, based on exposure data from leading institutions.
3. Critical evaluation of residual risk level: We assess mitigating and aggravating factors based on expert knowledge of asset operations and value chain dependencies and adaptations put in place by the business.
4. Climate-adjusted valuation: We assess the financial impact of the residual risk and/or necessary adaptations to further reduce residual risk.

PHYSICAL CLIMATE RISK CASE STUDY

Max Healthcare

Max Healthcare is one of India's largest healthcare organisations and primarily serves domestic patients. It operates seventeen hospitals and other healthcare facilities across the National Capital Region (NCT) of Delhi, Haryana, Punjab, Uttarakhand Maharashtra and Uttar Pradesh.

Headlines

- We have assessed physical climate risk across Max's hospital portfolio, identifying inland flooding, heat and water stress as major risks.
- Inflationary costs are expected due to heat risk, and associated air quality risk, because of the energy demands of heating, ventilation, and air conditioning (HVAC) and air filtration systems.
- Capital expenditure (capex) spend on energy and water efficiency are expected to increase over time as the need to offset inflationary energy costs and avoid freshwater disruptions increases.
- Further capex spend could be required to manage flood risk.
- We are integrating increased energy and capex costs into our climate-adjusted valuation model.

Further capex spend could be required to manage flood risk.

Assessing physical risk

Our physical risk assessment focuses on the company's hospital assets, as the key revenue driver of the business. The company has seventeen hospitals (existing and under construction) across nine different provinces in India. We screened the exposure level of each asset to seven key categories of physical climate risk, and then assessed the residual risk to overall operations for each category. In terms of value chain, we prioritised assessing the exposure and residual risk to communities surrounding each hospital, as these communities form the company's patient base. A summary of our residual risk conclusions are included in Figure 4.

[11] Physical climate risks considered: Sea level rise/coastal flood risk, cyclones/storm surge, coastal erosion, inland flooding, pervasive droughts and water stress, heatwave/pervasive heat stress, wildfires.

Figure 4: Residual risk level assessed for key physical climate risks

Physical climate risk(s)	Total Assets with Medium, High or Very High risk	Residual risk level to operations	Residual risk level to value chain: Patients
Inland flooding Current proxy: Riverine flood risk, urban flood risk	16	Medium to high	Very high
Sea level rise/coastal flood risk Current proxy: Coastal flood risk	1	Low to Medium	High
Cyclones/storm surge Current proxy: Cyclone risk	1	Medium	High
Coastal erosion Current proxy: Coastal flood, cyclone, landslides risk	1	Very Low	Low
Pervasive droughts and water stress Current proxy: Drought/water scarcity, water stress	17	Medium	Very high
Heat waves/Pervasive heat stress Current proxy: Extreme heat (heat wave) risk	17	Medium	Very high
Wildfires Current proxy: Wildfire risk	17	Low to Medium	Medium

Sources: WRI Aqueduct, ThinkHazard!

We then identified potential financial impacts to hospitals and their value chain (noting that value chain impacts are often opaque). The likelihood and/or materiality of each financial impact was assessed before concluding whether this impact should be integrated into the valuation model. A summary of the potential financial impacts identified is provided in Figure 5, including the status of their integration into the valuation model[12] (note: the assessment is ongoing). We also summarised what informed the residual risk decisions for inland flooding and heat risk, and the conclusions on their key potential financial impacts.

Figure 5: Potential financial impact of physical climate risks

	Potential financial impacts *Indicates risks assessed as most material potential valuation impact in short-medium term	Status
Capex	**Flood –** higher capex spend required in short-medium term for necessary flood adaptations to reduce residual risk.	Assessing materiality and/or ability to estimate potential valuation impact
	Water security – relating to adaptations for water efficiency and/or treatment/reuse to strengthen water security.	Estimating impact in climate-adjusted valuation model
	Heat – higher capex spend required in short-medium term for necessary HVAC, air filtration installations and/or efficiency improvements to manage inflationary costs.*	
	Air quality – higher capex spend required in short-medium term for necessary air filtration installations and/or efficiency improvements to manage inflationary costs. Note: Heat and wildfire smoke worsen air quality.	
	Power supply – higher capex spend required in short-medium term for generators required to ensure uninterrupted operations incase of blackouts.	No valuation impact assessed or currently being explored
Operating costs	**Water costs –** potential increased cost of attaining fresh water and/or regulatory requirement for greater water efficiency.	No valuation impact assessed or currently being explored
	Heat – increased HVAC costs associated with increased cooling demands in hospitals e.g. increased HVAC usage across year.	Estimating impact in climate-adjusted valuation model
	Air quality – increase air filtration costs associated with increased air filtration requirements due to heat and smoke worsening air quality.*	Estimating impact in climate-adjusted valuation model
	Supply chain – related to interuptions to medical supply chain e.g. equipment and medicines.	Assessing materiality and/or ability to estimate potential valuation impact

[12] Key reasons for a status of 'No valuation impact assessed or currently being explored' include: Low likelihood of financial impact materialising, low materiality assessed for the potential financial impact. Potential risks with this status will still be monitored in case of future changes.

	Potential financial impacts *Indicates risks assessed as most material potential valuation impact in short-medium term	Status
Revenues	**Flood/storm/heat –** from interruptions to hospital access for patients, and/or staff (including hospital fleets e.g. ambulances) i.e. reducing operating capacity.	**Assessing materiality and/or ability to estimate potential valuation impact**
	Water access – from interruptions to hospitals operations due to lack of water access.	**No valuation impact assessed or currently being explored**
	Flood/cyclone/wildfire – from interruptions to hospital operations due to damage from acute physical climate risk event.	**Assessing materiality and/or ability to estimate potential valuation impact**
	Increased demand – the acute and chronic health impacts of climate change are expected to increase healthcare demand.	**Assessing materiality and/or ability to estimate potential valuation impact**
Stranded assets	**Sea level rise combined with flood, storm surge/cyclone risk –** risk of singular coastal asset (Mumbai hospital) or its surrounding area being permanently or frequently inundated due to combined impact of sea level risk, flood and cyclone risk.	**Assessing materiality and/or ability to estimate potential valuation impact**
Insurance costs	**Flood, storm surge/cyclone, wildfire –** costs of gaining coverage for uncovered assets to appropriately manage risk, or of increased insurance costs over time.	**Assessing materiality and/or ability to estimate potential valuation impact**

Source: Federated Hermes

The health and safety of local populations is at very high risk during flooding events, and hospital access becomes difficult.

Inland flooding (urban)

10 hospitals have high exposure to urban flood risk and the geographic proximity of nine of these hospitals heightens associated risk concerns, given a flooding event could impact multiple facilities at once. There have been no recent significant flooding events, however some hospitals have experienced minor flooding during heavy rains. Each hospital has flood management adaptations such as drainage systems, water pumps. The health and safety of local populations is at very high risk during flooding events, and hospital access becomes difficult. This generally results in reduced patient numbers during flooding events, and a high patient influx in the days following as access is restored.

Heat waves/pervasive heat stress

All hospitals are in high-heat stress areas and the geographic proximity of many of these hospitals, as well as the seasonality of heat wave risk heightens associated risk concerns. Hospitals must maintain appropriate temperatures and air quality for patient safety, as the heat is known to worsen air quality. Each hospital has HVAC and air filtration systems in place, which generally account for the majority of building energy consumption. The costs of HVAC are increasing year-on-year due to heat intensity e.g. some systems are required to run for 24 hours during summer. The company has a strategic focus on system efficiency, and has invested approximately 0.7% of total capex, on average, over the last three years in technologies for improving environmental and social impact including energy conservation projects. Over 50% of the total built-up area is certified gold under Indian Green Building Council (IGBC) norms. This equates to six hospitals currently and LEED[13] gold status is targeted for all new facilities.

Assessing financial impact

Inflationary costs – heat/air quality

We are integrating increased cost projections for heat and air filtration related energy consumption into our climate-adjusted valuation model, as we expect these costs will become increasingly material, despite efficiency efforts.

Capex requirements – water security, heat and air quality

The complete coverage of HVAC and air filtration systems across the portfolio, high efficiency standards of much of the building stock, and ongoing capex investment in efficiency, reduces the likelihood of large future capex costs to manage water, heat and air quality risks. However, we are integrating increased capex spend into our climate-adjusted valuation model as we estimate this spend will continue to increase overtime as the need to offset inflationary energy costs and avoid freshwater disruptions increases.

Capex requirements – flooding

Existing adaptations significantly reduce the requirement for future capex spend on flood mitigation and adaptation. However, we currently lack specificity on the adaptations in place and their coverage across all hospital assets, including stress-testing performed against future flood risk levels. This means we are uncertain whether the current adaptations are fit-for-purpose. The results of these findings could mean there is an additional capex spend required to appropriately manage this risk, which should be considered in the valuation model.

[13] Leadership in Energy and Environmental Design' (LEED) is a rating system to evaluate the environmental performance of buildings and measure their sustainability.

CLIMATE TRANSITION RISK CASE STUDY

Rumo SA

Rumo is the largest freight railway operator in Brazil. With near 13,500 km of railway lines, 1,200 locomotives, and 33,000 railcars, it operates across the central-west, southern, southeastern, and northern regions, home to four of the country's leading ports, through which the majority of Brazil's grain production is exported.

Headlines

- We have assessed Rumo's climate transition risk, focusing on the company's fossil fuel-dependent locomotive fleet and the potential financial impacts of decarbonising this fleet
- Four potential decarbonisation strategies were identified: full electrification, hybrid locomotives, hydrogen locomotives and increased biofuel blending.
- Hybrid locomotives were identified as the most realistic medium-term decarbonisation strategy for the company; due to the current lack of readiness and/or suitability of alternatives.
- This strategy is expected to increase capex costs, due to more expensive hybrid power systems, but reduce fuel costs; with these impacts now being estimated in our climate-adjusted valuation model.

Assessing transition risk

Our transition risk assessment focuses on Rumo's freight railway system, driven by a diesel-to-power locomotive fleet. Rail freight is inherently more sustainable than the alternative of road freight for ground transport due to its lower energy and emissions intensity; helping contain the energy demand of the transport sector. However, Rumo's fossil-fuel dependent[14] system still exposes the company to climate transition risk, and an appropriate transition pathway is required to manage this risk and align with a net zero 2050 trajectory.

We have assessed the potential risks/opportunities to the company's current business model of an economic transition to net zero, and the risks/opportunities of implementing four potential decarbonisation strategies: full electrification, hybrid locomotives, hydrogen locomotives and increased biofuel blending. Our assessment of these technologies considers Rumo's locomotive supply chain. A summary of the potential financial impacts of key risks/opportunities identified is provided in Figure 6, including the status of their integration into the valuation model (note: the assessment is ongoing). We have also highlighted some of the key findings of our assessment and how it has informed our climate-adjusted valuation model so far.

[14] Note: Approximately 95% of Rumo's Scope 1, 2 and 3 emissions relate to fuel and energy related activities.

Figure 6: Potential risks and financial impact

	Potential financial impacts *Indicates risks assessed as most material potential valuation impact in short-medium term	**Status**[15]
Cost impact of economic transition to net zero e.g. regulatory change, supply/ demand shifts	**Diesel fuel cost change –** due to diesel price change in response to demand/supply shifts as local and/or global economy transitions away from fossil fuels.	**Assessing materiality and/or ability to estimate potential valuation impact**
	Biofuel cost change – due to increased regulatory biofuel blend requirements; and/or due to ethanol price change in response to demand/supply shifts as local and/or global economy transitions away from fossil fuels.	**Assessing materiality and/or ability to estimate potential valuation impact**
	Carbon cost risk – if carbon price applied to diesel fuel in Brazil.	**No valuation impact assessed or currently being explored**
Cost impact of biofuel strategy	**Maintenance costs –** potential change in maintenance costs due to expanded use of biofuels.	**Already assessed within standard valuation model**
Cost impact of hybrid locomotive strategy	**Diesel fuel savings –** as a result of greater fuel efficiencies of hybrid locomotives	**Estimating impact in climate-adjusted valuation model**
	Electricity costs – due to potential requirement to recharge batteries in hybrid locomotive models.	**No valuation impact assessed or currently being explored**
	Maintenance costs – potential change in maintenance costs of hybrid locomotive models compared to existing diesel-to-power systems.	**Assessing materiality and/or ability to estimate potential valuation impact**
Cost impact of hydrogen locomotive strategy	**Hydrogen fuel costs –** potentially significantly higher than current diesel fuel costs.	**No valuation impact assessed or currently being explored**
	Maintenance costs – potential change in maintenance costs of hybrid locomotive models compared to existing diesel-to-power systems	**No valuation impact assessed or currently being explored**
Cost impact of full electrification strategy	**Diesel fuel savings –** due to switch to electricity as power source.	**No valuation impact assessed or currently being explored**
	Electricity costs – electricity as new power source for locomotives.	
	Maintenance costs – potential change in maintenance costs of fully electrified model compared to existing diesel-to-power systems.	
Capex impact of efficiency strategy	**System efficiency improvements/upgrades**	**Already assessed within standard valuation model**
Capex impact of hybrid strategy	**Locomotive retrofits to change to hybrid power system**	**Estimating impact in climate-adjusted valuation model**
	Hybrid locomotive purchases	
Capex impact of hydrogen strategy	**Locomotive retrofits to change to hybrid power system**	**No valuation impact assessed or currently being explored**
	Hybrid locomotive purchases	
Capex impact of full electrification strategy	**Electric locomotives overhead line equipment (OLE) system transition**	**No valuation impact assessed or currently being explored**
Revenue loss/ gain	**Substitution risk –** customers transitioning to lower carbon freight alternatives.	**No valuation impact assessed or currently being explored**
	Reduced rail capacity due to locomotive availability impacts from power system retrofits (hybrid or hydrogen).	**No valuation impact assessed or currently being explored**
	Demand reduction in key goods transported due to climate impact, thus reducing transport volumes.	**No valuation impact assessed or currently being explored**
Stranded assets	**Diesel locomotives**	**No valuation impact assessed or currently being explored**

Source: Federated Hermes

[15] Key reasons for a status of 'No valuation impact assessed or currently being explored' include: Low likelihood of financial impact materialising, low materiality assessed for the potential financial impact. In the case of the potential financial impacts of pursuing a certain decarbonisation pathway, this status may reflect that the strategy is currently considered unrealistic to implement. Potential risks with this status will still be monitored in case of future changes.

Our analysis concluded that **hybrid locomotives are the most realistic medium-term decarbonisation strategy for the company**; this aligns with the company's own conclusions. The disruption of diesel as its key fuel source is not expected in the next decade due to the size of the diesel system in operation and the lack of readiness and/or suitability of technologies that will disrupt this fuel source.

- **Full-scale electrification** is unrealistic for Rumo over this time period primarily due to the prohibitive costs of associated infrastructure; as well as the volatility of Brazil's predominantly hydro-power system and lack of electrification incentives.
- **Increasing the biofuel-blend** beyond the mandated percentage blend[16] is not expected in the medium term due to issues around performance loss,[17] increased maintenance costs, and the higher cost of biofuels.
- **Hydrogen locomotives** are an increasingly viable rail freight net zero technology, with various trials and small-scale implementations occurring worldwide. However, challenges around the supply and cost of green hydrogen; the scalability and suitability of hydrogen locomotive technologies e.g. performance, infrastructure costs, are ongoing.

As such, our climate-adjusted valuation model will initially focus on modelling the medium term (five to ten years) introduction and gradual expansion of hybrid locomotives into the fleet. This will assume a retrofit of existing locomotives with hybrid power systems until hybrid locomotives account for approximately 50% of the fleet. Hybrid power systems are more expensive to acquire due to battery costs, meaning the key focus will be assessing whether the fuel savings offered by the hybrid locomotives offset this higher capex expense. The potential impact on maintenance costs may also be modelled in future once assessed further.

Outside the hybrid strategy, we continue to explore the potential financial impacts of future diesel and/or biofuel price changes that may result from the economic transition to net zero.

> **Hybrid locomotives are the most realistic medium-term decarbonisation strategy for the company.**

GEMs summary and next steps

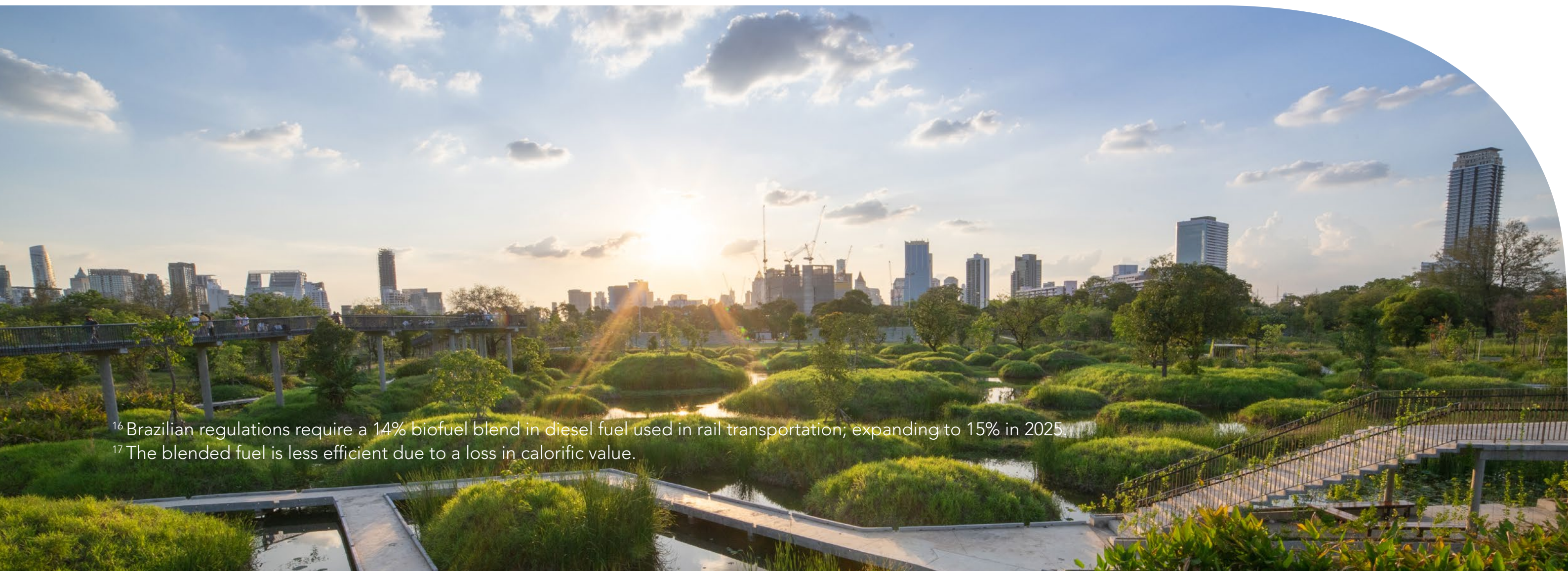
The second half of 2024 saw continued progress from GEMs Equity holdings which have been responsive to engagement and share our vision that sustainability is an integral part of long-term value creation. The path ahead is certainly not linear, as evidenced by President Donald Trump's withdrawal from the Paris Agreement and the recent failure to reach a global agreement on plastics in Busan, South Korea. Yet continued attention to material issues such as biodiversity and nature by civil society, corporate and governments alike will help ensure that these important topics remain on the agenda.

We are starting to see some constructive policies emerge and remain positive about opportunities for quality and growth companies that show promising ESG momentum.

The GEMs Equity Strategy will continue to:

- Assess the physical and climate risks that our holdings face, with in-depth research into higher-risk names.
- Prioritise engagement with companies to future proof against medium- and long-term risks, particularly focusing on higher emitters in the portfolio.
- Evaluate our impact across a range of outcome metrics including CO_2 avoided, water saved, and jobs created.

We will also deepen our analysis of the **biodiversity impacts** and dependencies of our holdings with a view to future proofing the portfolio and ensuring that any negative impacts are mitigated. The next ESG Materiality report (H1 2025) will provide an update on our approach to biodiversity, sharing the outputs of our initial assessments and engagements.



[16] Brazilian regulations require a 14% biofuel blend in diesel fuel used in rail transportation; expanding to 15% in 2025.
[17] The blended fuel is less efficient due to a loss in calorific value.

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